South African Reserve Bank

National Payment System Department

Position Paper on Electronic Money

Position Paper NPS 01/2009

Dated November 2009

1. Executive summary

This document outlines the position of the South African Reserve Bank (the Bank) with regard to electronic money (e-money). The Bank, in its endeavour to reduce risk in the national payment system (NPS), will only allow registered South African banks[1] to issue e-money. However, the Bank will continue to evaluate its position paper as and when required by future developments.

2. Background

The NPS encompasses the entire payment process from payer to beneficiary and includes the settlement between banks. The process includes all the tools, systems, mechanisms, institutions, agreements, procedures, rules or laws applied or utilised to effect payment. The NPS facilitates the circulation of money, that is, it enables transacting parties to exchange value.

Central banks worldwide are constantly reviewing their regulatory position with regard to e-money in its various forms, among other things, Internet banking, mobile payments, mobile banking and prepaid instruments. More specifically, central banks are continuously investigating the impact these products will have on the regulatory and operational requirements that are necessitated by these means of payments.

The Bank takes note of initiatives in South Africa and internationally, and welcomes innovative new technological developments. The Bank wishes to familiarise itself with any new developments and the potential risks that these developments may pose for the NPS.

The Bank will continue to assess the benefits that new payment innovations could provide to the country as a whole, including the utilisation of such

[1] For purposes of this Position Paper a bank can be defined as a commercial bank or branch of a foreign institution registered in terms of the Banks Act, 1990 (Act No. 94 of 1990), a mutual bank registered in terms of the Mutual Banks Act, 1993 (Act No. 124 of 1993) and a co-operative bank registered in terms of the Co-operative Banks Act, 2007.

innovations and developments for enhancing efficiency and access to financial services.

Following recent investigations by the Bank, which included the feasibility of allowing non-banks to issue e-money, it has become necessary for the Bank to publish an updated position paper to clarify its policy with regard to e-money.

3. Definition of electronic money

For purposes of this position paper, e-money is defined as monetary value represented by a claim on the issuer. This money is stored electronically and issued on receipt of funds, is generally accepted as a means of payment by persons other than the issuer and is redeemable for physical cash or a deposit into a bank account on demand.

4. The role of the Bank

As overseer, the role of the Bank is to promote the safety and efficiency of the payment system. The Bank takes cognisance of new developments and their impact on the integrity of the NPS and, as far as possible, strives towards minimising payment system-related risks for all participants.

In terms of overseeing the payment system, the Bank always acts in the interest of the system as a whole and not that of any individual stakeholder.

Although electronic payment technologies have developed significantly since the introduction of the concept of e-money in the early nineties, the regulation thereof is constantly being developed. The Bank, therefore, has been cautious not to stifle development and has always maintained a position that regulation of e-money products and schemes will be applied appropriately as innovation occurs.

The Bank has always taken a direct interest in the developments and the likely implications of electronic payments, but realises that emerging e-money products

may require regulatory adjustment or intervention, which may arise from the need to:

a) maintain the integrity, confidence and limit the risk in the NPS;
b) assist other regulatory authorities in providing consumers with adequate protection from unfair practices, fraud and financial loss; and
c) assist law enforcement agencies in the prevention of criminal activity.

5. The Bank's intent with regard to electronic money

The Bank considers e-money to be a supplement to physical notes and coin in the long term. In order to facilitate the development of e-money products and the opportunities that they present on a national and regional basis, the Bank will:

a) support the development of a banking industry vision for electronic substitutes for physical banknotes and coin;
b) support the development of national standards to enable interoperability of e-money products and devices (as discussed in section 9); and
c) participate in initiatives aimed at providing secure payment instruments for the general public, including the unbanked and rural communities of South Africa and the southern African region.

6. Legal and regulatory framework

In terms of section 10 (1) (c) of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989 – the SARB Act), the Bank is required to perform such functions, implement such rules and procedures and, in general, take such steps as may be necessary to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems. Furthermore, the National Payment System Act, 1998 (Act No. 78 of 1998 – the NPS Act) provides for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in South Africa, and to provide for connected matters.

The NPS Act, therefore, provides the regulatory and supervisory power to the Bank to manage and control payment system risk.

All e-money-related schemes must not be in contravention of any legislation, with reference to among others:

- the South African Reserve Bank Act, No. 90 of 1989;
- the National Payment System Act, No. 78 of 1998;
- the Banks Act, No. 94 of 1990;
- Exchange Control Regulations; and
- the Financial Intelligence Centre Act, No.38 of 2001.

The Bank is continuously requested to evaluate legal and regulatory implications of emerging systems and products in the payment system. One factor which surfaces regularly is the control of the money or the "float" that would accumulate in such a system. The following section explains the difference between providing third-person payments and the transfer of money from person to person.

6.1 Payment due versus deposit-taking

Section 7 of the NPS Act allows a person, as a regular feature of that person's business, to accept money or payment instructions from any other person for purposes of making a payment on behalf of the first person, to a third person, to whom the payment is due. This implies that there is an obligation that must be settled, for example the payment of rates and taxes to a municipality. This service may be provided by non-banks in accordance with Directive No. 1 of 2007[2], which is the directive in respect of payments to third persons.

Many of the applications made to the Bank revolve around the ability to provide person-to-person payments. This involves a payer sending electronic value to a beneficiary who is then able to encash that value. This money is not normally due to the beneficiary in terms of an obligation and would contravene section 7 of the NPS Act and be classified as "deposit-taking" in terms of the Banks Act.

[2] Directive No.1 of 2007- Directive for the conduct within the National Payment System in respect of payments to third persons available online at: http://www.reservebank.co.za/.

Section 11 of the Banks Act, 1990 (Act No. 94 of 1990 – the Banks Act) provides that no person may conduct the "business of a bank" unless such a person is a public company and registered as a bank.

The "business of a bank" is defined in the Banks Act and can be described as "the soliciting or advertising for or the acceptance of 'deposits' from the general public as a regular feature of the business in question". (There are a number of exclusions and exemptions to the above-mentioned prohibition.)

A "deposit" is comprehensively defined in the Banks Act, but can simply be described as an amount of money paid by one person to another person subject to an agreement in terms of which an equal amount or any part thereof will be repaid on demand, on a specified or unspecified date or in circumstances agreed upon. (There are also a number of specified exceptions to the above-mentioned general definition.)

The legal nature of money is, however, such that when one person hands over an amount of money to another person in trust, the money (physical notes and coin) generally becomes the property of the person receiving it and hence part of his/her estate. In the case where such a person loses the money, steals the money or becomes insolvent, the person that handed over the money merely has an (unsecured) claim against the other person or his/her estate. This of course places the person that handed over the money in a very precarious position and it is one of the reasons that deposit-taking on a large scale and hence the business of a bank is such a risky business and why banks are regulated and supervised to such a high degree. If the taking of deposits from the general public is a risky business for banks despite its regulation and ongoing supervision, it is even more risky when deposits are taken from the general public by unregulated and unsupervised persons and entities.

The fact of the matter is that the taking of deposits from the general public by an unregistered person (non-bank) is a criminal offence in terms of the provisions of the Banks Act. Criminal offences are investigated by the South African Police

Service (SAPS) and perpetrators are prosecuted by the National Director of Public Prosecutions in a competent court of law. The Bank Supervision Department has no powers to perform such functions and merely assists the above-mentioned authorities if and when requested to do so.

7. Issuers of electronic money and non-bank participation

Due to the nature of e-money, as described in this Position Paper, only South African registered banks may issue e-money.

As per the requirements of the Banks Act, deposits of e-money would have to be held in a separately identifiable e-money account for each holder of e-money and comply with the relevant sections of the Banks Act and its Regulations.

The onus will be on the issuer of the e-money to ensure that all relevant legislation is adhered to, including the legislation mentioned in section 6 above.

Any person wishing to issue e-money must ensure that the public using the e-money is made aware of the conditions of use the liability of the issuer and what recourse the holder of the e-money would have in relation to the issuer.

Section 52 of the Banks Act allows for non-banks to enter into arrangements with banks that may allow them to offer payment-related services in conjunction with the bank. Application for such arrangements would be required to be made by the bank concerned to the Registrar of Banks.

Non-banks may also provide services as system operators or third-person payment service providers in terms of Directives 1 and 2 of 2007[3] respectively.
As the issuance of e-money involves clearing and settlement, the normal arrangements pertaining to clearing and settlement will remain. Sponsored banks are required to enter into an agreement with a settlement bank, whereby

[3] Directive No. 1 of 2007 – Directive for the conduct within the National Payment System in respect of payments to third persons; and
Directive No.2 of 2007 – Directive for conduct within the National Payment System in respect of system operators. Both directives are available online at: http://www.reservebank.co.za.

the settlement bank will be responsible for the risks involved in settlement[4] on behalf of the non-settlement participant. Both sponsoring and sponsored bank must ensure that the necessary legal agreements are in place.

8. Redemption of electronic money

A bank, as the holder of an e-money deposit, must, on demand, redeem the electronic value held on the instrument for central bank currency, at par.

9. Interoperability of electronic money

Interoperability can be defined as the ability of different types of computers, networks, operating systems, applications and other infrastructure, of the different banks to work in partnership effectively, without interruption, explicit communication or translation prior to each event, in order to enhance the efficiency of the payment system. In this context interoperability refers to technical interoperability and is the ability of e-money systems to be integrated through the use of agreed standards and specifications.

Interoperable systems lead to the development of large network externalities which will, in the longer term, reduce operational cost and complexity for all customers.

If more than one settlement system participant issues e-money, an e-money Payment Clearing House (PCH) may be established by the Payment System Management Body (PASA) to ensure interoperability and appropriate rules for clearing and settlement of similar e-money transactions between these banks.

10. Information security requirements for electronic money

Information security is critical to the success of e-money services and their operational services. No information or funds transfer in the payment system

[4] Refer to section 4(2)(d)(i) of the NPS Act, available online at: http://www.reservebank.co.za.

should be vulnerable to interception by unauthorised users. Therefore, the technology used in e-money must be secure and ensure confidentiality, integrity, authenticity and non-repudiation. Furthermore, the e-money security and operational services should meet the requirements of international standard bodies.

11. Financial Intelligence Centre Regulations

This position paper supports the approach and limits for particular classes of transactions published by the Financial Intelligence Centre.

12. Correspondent banking arrangements

Banks, in consultation with the Bank, may extend their e-money activities across borders based on normal correspondent banking arrangements. All relevant legislation, including Exchange Control Regulations, must be complied with.

13. Submissions to the Bank

Any bank wishing to provide e-money services needs to advise the Bank, at least six weeks before the roll out of any pilot, of its intention, and furnish the Bank with full details of its intended proposals.

Furthermore, in terms of section 10 of the NPS Act, the Bank reserves the right to request any information pertaining to a payment system, and any person must, on request, provide such information to the Bank in such form and at such time as the Bank may require.

Any person who is uncertain as to whether their current or future business practices are aligned with this position paper should initiate discussions with the National Payment System Department of the Bank to clarify the matter.

14. Conclusion

The Bank will, from time to time, issue explanatory notes regarding this paper to clarify its position on specific emerging payment-related matters. These explanatory notes should be read in conjunction with this paper.

Any enquiries or clarification concerning this position paper may be addressed to the following e-mail address: npsdirectives@resbank.co.za.